FILED
MAR 31 1989
JOSEPH F. SPANIOL
CLERK

No. 88-1177

IN THE
Supreme Court of the United States
OCTOBER TERM, 1988

MUSTANG FUEL CORPORATION (formerly MUSTANG ENERGY CORP.),
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION, *et al.*,
Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

REPLY BRIEF OF PETITIONER TO BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION

DAVID O. CORDELL
MUSTANG FUEL CORPORATION
2000 Classen Center
800 East
2000 Classen Blvd.
Oklahoma City, OK 73106
(405) 557-9400

CARROLL L. GILLIAM *
RICHARD A. DROM
CATHERINE E. BOCSKOR
GROVE, JASKIEWICZ, GILLIAM AND COBERT
1730 M Street, N.W.
Washington, D.C. 20036
(202) 296-2900

* Counsel of Record

March 31, 1989

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

TABLE OF CONTENTS

	Page
STATEMENT	1
ARGUMENT	2
CONCLUSION	9

TABLE OF AUTHORITIES

Cases:

Colorado Interstate Gas Company v. *FERC*, 791 F.2d 803 (10th Cir. 1986), cert. den., 107 S. Ct. 907 (1987)	5
East Tennessee Natural Gas Company v. *FERC*, 863 F.2d 932 (D.C. Cir. 1988)	2, 4
Jersey Central Power & Light Company v. *FERC*, 810 F.2d 1168 (D.C. Cir. 1987) (*en banc*)	7
Tennessee Gas Pipeline v. *FERC*, 867 F.2d 688 (D.C. Cir. 1989)	2, 3, 4, 8
Tennessee Gas Pipeline v. *FERC*, No. 87-1368 (D.C. Cir., Mar. 10, 1989)	4

Statutes and Regulations:

Natural Gas Act of 1938, 15 U.S.C. § 717, *et seq.*:	
Section 4, 15 U.S.C. § 717c (1976)	4, 5
Section 5, 15 U.S.C. § 717d (1976)	4, 5
Natural Gas Policy Act of 1978, 15 U.S.C. § 3301 *et seq.*:	
Section 311(a)(2), 15 U.S.C. § 3371(a)(2)	2, 4, 8
Section 311(a)(2)(B)(ii), 15 U.S.C. § 3371 (a)(2)(B)(ii)	5

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

No. 88-1177

MUSTANG FUEL CORPORATION (formerly MUSTANG ENERGY CORP.),
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION, *et al.*,
Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

---

REPLY BRIEF OF PETITIONER TO BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION

Pursuant to Rule 22.5, Petitioner Mustang Fuel Corporation (formerly Mustang Energy Corp.) replies to the Brief for the Federal Energy Regulatory Commission filed on March 24, 1989.

STATEMENT

New decisions in the D.C. Circuit since the filing of the petition by Mustang Fuel Corporation ("Mustang") on January 17, 1989: (1) support Mustang's assertion of conflicts among the circuits as to lawfulness of retro-

active elimination of a contractual minimum bill by the Federal Energy Regulatory Commission ("Commission"); (2) add to reasons this Court should grant Mustang's petition, and (3) negate the Commission's assertions that no conflicts exist and further review by this Court is unwarranted.

ARGUMENT

The Commission's brief in opposition seeks to establish that the Commission correctly applied the "fair and equitable" standard of Section 311(a)(2) of the NGPA, 15 U.S.C. 3371(a)(2), and that there are no conflicts among the circuits as to issues decided by the Tenth Circuit in this case.

1. As Mustang has shown, the Tenth Circuit decision conflicts with recent D.C. Circuit opinions. In both *East Tennessee Natural Gas Company* v. *FERC*, 863 F.2d 932 (D.C. Cir. 1988), and *Tennessee Gas Pipeline* v. *FERC*, 867 F.2d 688 (D.C. Cir. 1989), agreements between the pipelines and their customers contained mechanisms to protect the pipeline from underrecovery of fixed costs (a minimum bill in the first case and a similar "demand charge" in the latter). In both cases, the D.C. Circuit remanded to the Commission because of the Commission's attempts to eliminate the billing provision retroactively. See Pet. Br. 26-27.

More recent opinions by the D.C. Circuit further support Mustang as to the conflict between the Tenth and D.C. Circuits. On February 10, 1989, the D.C. Circuit reaffirmed its December, 1988 *East Tennessee* opinion in *Tennessee Gas Pipeline* v. *FERC*, 867 F.2d 688. In the latter case, despite a contractual agreement between the pipeline and its customers for transportation service based on a one-part demand rate, the Commission attempted to require the company to substitute a two-part rate that included a "commodity charge" and a "demand charge." 867 F.2d 688, slip op. at 5. The court

found that the Commission had failed to explain this shift of policy and effort to prevent Tennessee from charging the contractually-agreed "one-part" rate, consisting exclusively of a demand charge.[1]

The court noted that a minimum bill is similar to a demand charge in that it is payable regardless of the customer's actual gas purchases. 867 F.2d 688, slip op. n.3 at 5.

In discussion of the one-part demand rate, the D.C. Circuit observed that the pipeline had repeatedly pointed out that the Commission had in the past allowed a one-part demand rate for new facilities for customers who contracted to pay in that manner. 867 F.2d 688, slip op. at 9. In addition, as here, the Commission had previously approved the pipeline's one-part demand rate in passing upon an earlier filing concerning the same transportation service. 867 F.2d at 688, slip op. at 4. The D.C. Circuit stated that the Commission cannot, without adequate explanation, so set aside "expectations" memorialized in contracts and allowed by the Commission itself in earlier proceedings:

> As we have said more than once before, "[t]he Commission may not 'cavalierly disregard[] private contracts' in exercising its authority under the NGA." *Tennessee Gas Pipeline Co. v. FERC*, 824 F.2d 78, 82 (D.C. Cir. 1987) (quoting *ANR Pipeline Co. v. FERC*, 771 F.2d 507, 519-520 (D.C. Cir. 1985)).
>
> . . . The technical fact that the Phase 2 settlement agreement "supersedes" Phase 1 hardly eradicates the contracts or the Commission's prior blessing. The costs are sunk and the contracts long dry. As in

---

[1] A "demand charge" is a rate paid by customers of a pipeline which rate is set according to the number of units of gas the customer is entitled to buy or ship. *Tennessee Gas Pipeline* v. *FERC*, 867 F.2d 688, slip op. at 2.

> the earlier *Tennessee* case, the Commission's rejection of the contracts here seems distinctly cavalier.

867 F.2d 688, slip op. at 10.[2]

Facts here are similar, and so is the law under the Natural Gas Act and the NGPA. Here, parties also had contractually agreed to the minimum bill and the provision was left unchanged in a settlement approved by the Commission in 1982. However, in the next rate filing in which the minimum bill was *not* put in issue by Mustang, the Commission, nevertheless, eliminated that billing provision retroactively despite its prior approval of minimum bills in this and other cases (App., 6a-8a, 27a-28a). The D.C. Circuit, unlike the Tenth, would hold this reversible error.

The Commission's brief in opposition seeks to distinguish the *East Tennessee Natural Gas Co.* v. *FERC* case (and presumably would similarly so seek to distinguish the D.C. Circuit's February 10, 1989 *Tennessee Gas* decision), only by stating that Sections 4 and 5 of the Natural Gas Act ("NGA"), 15 U.S.C. 717c and 717d, were involved in the *East Tennessee* case, whereas the Mustang case involved the different regulatory structure of Section 311 of the Natural Gas Policy Act of 1978 ("NGPA"), 15 U.S.C. 3371(a)(2). Comm. Br. 13. Yet, below and here, the Commission continuously relies upon NGA authorities and decisions to justify its construction and application of Section 311(a)(2) of the NGPA.

The Tenth Circuit, however, was not as persuaded as to any such significant "distinction" between minimum

---

[2] See also *Tennessee Gas Pipeline Co.* v. *FERC*, No. 87-1368 (D.C. Cir. Mar. 10, 1989), slip op. 24, n.20, in which the D.C. Circuit addressed an intervenor's argument that the minimum bill should have been eliminated retroactively. The court concluded that this argument may be precluded by the court's decision in *East Tennessee Natural Gas Pipeline* v. *FERC*, 863 F.2d 932 (D.C. Cir. 1988).

bills under Sections 4 and 5 of the NGA and under Section 311 of the NGPA. The Tenth Circuit thus relied solely on NGA cases in issuing its decision approving the retroactive elimination of Mustang's minimum bill including *Colorado Interstate Gas Company* v. *FERC*, 791 F.2d 803 (10th Cir. 1986), cert. denied, 107 S.Ct. 907 (1987). App., 23a. This reliance on NGA cases by the Tenth Circuit underscores not only the importance of this case as a case of first impression in interpreting Section 311(a)(2) of the NGPA, but also the conflict with the D.C. Circuit's holdings.

2. In its argument as to the "fair and equitable" standard of Section 311(a)(2), the Commission states that this section ". . . does not ensure that petitioner will in fact recover expenses and earn a profit from its transportation services," and its application is consistent with the statutory mandate. Comm. Br. at 9. However, here, as below, the Commission indulges in a pretense that Mustang claims a "guarantee" of cost recovery and profit under this section (Comm. Br. at 8). This is not so.

The plain language of the statute, as Mustang has shown, mandates simply that the Commission *shall* "provide an opportunity for such pipeline to earn a reasonable profit." § 311(a)(2)(B)(ii)(II). App., 3a. Since at least 1982, the Commission has consistently ignored this clear statutory mandate in application of Section 311(a)(2) to intrastate pipelines. The Commission well may have "discretion" to apply a definition of "fair and equitable" rates under this section, but it cannot lawfully ignore Congress' precise statutory elaboration of exactly what the essential elements of "fair and equitable" rates are (namely, reasonable compensation to the intrastate pipeline for expenses incurred and provision for an opportunity to earn a reasonable profit. Section 311(a)(2)(B)(ii) of the NGPA). The Commission has not allowed the required opportunity, and its actions would be re-

versed by the D.C. Circuit under that court's constructions of analogous sections of the Natural Gas Act.

3. The Commission also takes issue with Mustang's contention that the Commission's orders place upon Mustang 100 percent of the burden of the customer's mistakes in projections of throughput volumes. The Commission characterizes this claim as groundless because, "although El Paso makes the initial projections, petitioner need not accept those estimates." See Comm. Br. 10, n.8.

This new-found Commission argument is, in fact, inaccurate and contrary to the El Paso-Mustang contract. Under that agreement, the projected volumes and the minimum daily quantity to be transported by Mustang for El Paso were totally controlled by El Paso. Contrary to the Commission, Mustang never had such a choice of rejecting El Paso's projected volumes. *If* Mustang did not plan to provide transportation of volumes projected by El Paso each year and did not provide sufficient available pipeline capacity to transport those projected volumes, Mustang could have been in breach of the contract for failure to provide this required capacity. Mustang thus had *no* basis or legal power to "not accept El Paso's estimates" as here suggested by the Commission in its brief. On this point, the Commission now errs as to facts as well as law.

4. The Commission also ignores the significance of minimum bills as mechanisms in transportation agreements designed to protect transporters from inaccurate projections by shipper customers. In disregard of the contractual *quid-pro-quos* and elimination of minimum bills retroactively, the Commission applies similar circular reasoning. Here, for example, it brushed aside impact with the supposition that "absent a minimum bill provision, we believe that Mustang will seek to get as accurate an estimate from El Paso as possible, so that its proposed rate will reflect its actual costs." App. 27a, 77a.

Mustang, like other companies, thus has been placed in a "Catch-22" posture whereby the Commission (1) first approves a settlement involving provision of a long-term transportation agreement including a minimum bill; (2) the companies then act in reliance upon such Commission approval; but (3) later, the Commission retroactively eliminates the minimum bills. The Commission then says: "Without the minimum bill you will be forced to try harder to get an accurate projection of yearly volumes from El Paso." Yet, by the time minimum bills are so eliminated retroactively, the transportation involved has long-since been completed so that transporters cannot, after the fact, "seek to get as accurate an estimate from El Paso as possible."

The ultimate result of such treatment of intrastate pipelines, as here, is retroactive shifting of the entire burden of accuracy of projections from the interstate pipeline and its stockholders to the intrastate pipeline, despite the interstate pipeline's agreement to a minimum bill. Here, the result is retroactive imposition of a refund liability of over $11 million, an amount in excess of Mustang's total net income from all of its customers for the year in which the refund was ordered. Pet. Br. 11, App., 83a. Such an "end result" is illegal under the Natural Gas Act and should likewise be condemned under the NGPA substantive standards.[3]

The Commission's brief, nevertheless, tries to show that Commission actions still afforded Mustang a fair "opportunity" to collect its actual cost of service and a reasonable rate of return on equity consistent with the holding in *Jersey Central Power & Light Company* v. *FERC*, 810 F.2d 1168 (1987) (en banc). Comm. Br. 12. This also is not so. In shifting all the risks of under-

---

[3] See *Duquesne Light Co., et al.* v. *Barasch, et al.*, —— U.S. —— (No. 87-1160, Jan. 11, 1989); *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968); and *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591 (1944).

utilization to Mustang *after the fact*, the Commission has ordered a refund which exceeded Mustang's total net income for the year ordered and imposed confiscatory rates and refund orders.

5. The Commission argues that its 1982 order approving Mustang's Period I rate structure (which contained a minimum bill) and initially authorizing Mustang's service under Section 311 of the NGPA [4] cannot be construed as open-ended approval of rates or the minimum bill because Mustang was required to file a new rate application each year. Comm. Br. 13.

Mustang did so file the required new rate application each year, but in its filings did not place the minimum bill in issue, but sought only a specific rate increase. The Commission itself put the minimum bill in issue by *sua sponte* eliminating the minimum bill, and this is the very type of action the D.C. Circuit struck down in *Tennessee Gas Pipeline v. FERC* on February 10, 1989. That court emphasized that the Commission cannot so set aside expectations memoralized in contracts and sanctioned by the Commission in prior proceedings without required findings and adequate explanations. 867 F.2d 688, slip op. at 10.

In sum, decisions by the D.C. Circuit since the petition was filed further show the Commission arguments are

---

[4] The Tenth Circuit opinion at issue here covered Periods I (Oct. 1, 1982-May 22, 1983) and II (May 23, 1983-Apr. 30, 1984) only. The rates for Periods III (May 1, 1984-Apr. 30, 1985) and IV (May 1, 1985-Apr. 30, 1986) are still pending at the Commission under Docket Nos. ST81-260-005, et al. All four of these currently are the subject of settlement negotiations by and among Mustang, the Staff of the Commission, and El Paso. If the settlement of these dockets currently under discussion were agreed to, that settlement would encompass the two periods covered by the Tenth Circuit opinion and the subject of the petition for writ of certiorari. If a settlement were agreed upon, approved by the Commission and final and no longer subject to judicial review, the petition in this case would be withdrawn.

without merit and provide no basis for denying Mustang's petition for writ of certiorari.

CONCLUSION

For the reasons stated in the petition and this reply brief, this Court should grant Mustang's petition, consider the "Questions Presented" (Pet. i), and reverse the court of appeals on those questions.

Respectfully presented,

DAVID O. CORDELL
MUSTANG FUEL CORPORATION
2000 Classen Center
800 East
2000 Classen Blvd.
Oklahoma City, OK 73106
(405) 557-9400

CARROLL L. GILLIAM *
RICHARD A. DROM
CATHERINE E. BOCSKOR
1730 M Street, N.W.
Washington, D.C. 20036
(202) 296-2900

* Counsel of Record

Of Counsel:
GROVE, JASKIEWICZ, GILLIAM AND COBERT
1730 M Street, N.W.
Washington, D.C. 20036
(202) 296-2900

March 31, 1989